

Excerpts from Office of Management and Budget Circular A-122 on employee compensation

2. **Factors affecting allowability of costs.** To be allowable under an award, costs must meet the following general criteria:
 - a. Be reasonable for the performance of the award and be allocable thereto under these principles.
 - b. Conform to any limitations or exclusions set forth in these principles or in the award as to types or amount of cost items.
 - c. Be consistent with policies and procedures that apply uniformly to both federally-financed and other activities of the organization.
 - d. Be accorded consistent treatment.
 - e. Be determined in accordance with generally accepted accounting principles (GAAP).
 - f. Not be included as a cost or used to meet cost sharing or matching requirements of any other federally-financed program in either the current or a prior period.
 - g. Be adequately documented.
3. **Reasonable costs.** A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with organizations or separate divisions thereof which receive the preponderance of their support from awards made by Federal agencies. In determining the reasonableness of a given cost, consideration shall be given to:
 - a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award.
 - b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.
 - c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal Government.
 - d. Significant deviations from the established practices of the organization which may unjustifiably increase the award costs.
7. **Compensation for personal services.**
 - a. **Definition.** Compensation for personal services includes all compensation paid currently or accrued by the organization for services of employees rendered during the period of the award (except as otherwise provided in **subparagraph h**). It includes, but is not limited to, salaries, wages, director's and executive committee

member's fees, incentive awards, fringe benefits, pension plan costs, allowances for off-site pay, incentive pay, location allowances, hardship pay, and cost of living differentials.

- b. **Allowability.** Except as otherwise specifically provided in this paragraph, the costs of such compensation are allowable to the extent that:

- (1) Total compensation to individual employees is reasonable for the services rendered and conforms to the established policy of the organization consistently applied to both Federal and non-Federal activities; and
- (2) Charges to awards whether treated as direct or indirect costs are determined and supported as required in this paragraph.

- c. **Reasonableness.**

- (1) When the organization is predominantly engaged in activities other than those sponsored by the Federal Government, compensation for employees on federally-sponsored work will be considered reasonable to the extent that it is consistent with that paid for similar work in the organization's other activities.
- (2) When the organization is predominantly engaged in federally-sponsored activities and in cases where the kind of employees required for the Federal activities are not found in the organization's other activities, compensation for employees on federally-sponsored work will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees involved.

- d. **Special considerations in determining allowability.** Certain conditions require special consideration and possible limitations in determining costs under Federal awards where amounts or types of compensation appear unreasonable. Among such conditions are the following:

- (1) Compensation to members of non-profit organizations, trustees, directors, associates, officers, or the immediate families thereof. Determination should be made that such compensation is reasonable for the actual personal services rendered rather than a distribution of earnings in excess of costs.
- (2) Any change in an organization's compensation policy resulting in a substantial increase in the organization's level of compensation, particularly when it was concurrent with an increase in the ratio of Federal awards to other activities of the organization or any change in the treatment of allowability of specific types of compensation due to changes in Federal policy.

- e. **Unallowable costs.** Costs which are unallowable under other paragraphs of this Attachment shall not be allowable under this paragraph solely on the basis that they constitute personal compensation.

- f. **Fringe benefits.**

- (1) Fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as vacation leave, sick leave, military leave, and the like, are allowable, provided such costs are absorbed by

all organization activities in proportion to the relative amount of time or effort actually devoted to each.

- (2) Fringe benefits in the form of employer contributions or expenses for social security, employee insurance, workmen's compensation insurance, pension plan costs (see **subparagraph h**), and the like, are allowable, provided such benefits are granted in accordance with established written organization policies. Such benefits whether treated as indirect costs or as direct costs, shall be distributed to particular awards and other activities in a manner consistent with the pattern of benefits accruing to the individuals or group of employees whose salaries and wages are chargeable to such awards and other activities.
 - (3)
 - (a) Provisions for a reserve under a self-insurance program for unemployment compensation or workers' compensation are allowable to the extent that the provisions represent reasonable estimates of the liabilities for such compensation, and the types of coverage, extent of coverage, and rates and premiums would have been allowable had insurance been purchased to cover the risks. However, provisions for self-insured liabilities which do not become payable for more than one year after the provision is made shall not exceed the present value of the liability.
 - (b) Where an organization follows a consistent policy of expensing actual payments to, or on behalf of, employees or former employees for unemployment compensation or workers' compensation, such payments are allowable in the year of payment with the prior approval of the awarding agency, provided they are allocated to all activities of the organization.
 - (4) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibility are allowable only to the extent that the insurance represents additional compensation. The costs of such insurance when the organization is named as beneficiary are unallowable.
- g. **Organization-furnished automobiles.** That portion of the cost of organization-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable as fringe benefit or indirect costs regardless of whether the cost is reported as taxable income to the employees. These costs are allowable as direct costs to sponsored award when necessary for the performance of the sponsored award and approved by awarding agencies.
- h. **Pension plan costs.**
- (1) Costs of the organization's pension plan which are incurred in accordance with the established policies of the organization are allowable, provided:
 - (a) Such policies meet the test of reasonableness;
 - (b) The methods of cost allocation are not discriminatory;
 - (c) The cost assigned to each fiscal year is determined in accordance with generally accepted accounting principles (GAAP), as prescribed in Accounting Principles Board Opinion No. 8 issued by the American Institute

of Certified Public Accountants; and

- (d) The costs assigned to a given fiscal year are funded for all plan participants within six months after the end of that year. However, increases to normal and past service pension costs caused by a delay in funding the actuarial liability beyond 30 days after each quarter of the year to which such costs are assignable are unallowable.
- (2) Pension plan termination insurance premiums paid pursuant to the Employee Retirement Income Security Act (ERISA) of 1974 (Pub. L. 93-406) are allowable. Late payment charges on such premiums are unallowable.
- (3) Excise taxes on accumulated funding deficiencies and other penalties imposed under ERISA are unallowable.
- i. **Incentive compensation.** Incentive compensation to employees based on cost reduction, or efficient performance, suggestion awards, safety awards, etc., are allowable to the extent that the overall compensation is determined to be reasonable and such costs are paid or accrued pursuant to an agreement entered into in good faith between the organization and the employees before the services were rendered, or pursuant to an established plan followed by the organization so consistently as to imply, in effect, an agreement to make such payment.
- j. **Overtime, extra-pay shift, and multi-shift premiums.** See **paragraph 32**.
- k. **Severance pay.** See **paragraph 49**.
- l. **Training and education costs.** See **paragraph 53**.
- m. **Support of salaries and wages.**
 - (1) Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports, as prescribed in **subparagraph (2)**, except when a substitute system has been approved in writing by the cognizant agency. (See **subparagraph E.2 of Attachment A**.)
 - (2) Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards. In addition, in order to support the allocation of indirect costs, such reports must also be maintained for other employees whose work involves two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s) (e.g., an employee engaged part-time in indirect cost activities and part-time in a direct function). Reports maintained by non-profit organizations to satisfy these requirements must meet the following standards:
 - (a) The reports must reflect an *after-the-fact* determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.

- (b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.
 - (c) The reports must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports.
 - (d) The reports must be prepared at least monthly and must coincide with one or more pay periods.
- (3) Charges for the salaries and wages of nonprofessional employees, in addition to the supporting documentation described in **subparagraphs (1) and (2)**, must also be supported by records indicating the total number of hours worked each day maintained in conformance with Department of Labor regulations implementing the Fair Labor Standards Act (FLSA) (29 CFR Part 516). For this purpose, the term "nonprofessional employee" shall have the same meaning as "nonexempt employee," under FLSA.
- (4) Salaries and wages of employees used in meeting cost sharing or matching requirements on awards must be supported in the same manner as salaries and wages claimed for reimbursement from awarding agencies.